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Before The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

JUL 1 1994

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of)

Implementation of Sections of)
the Cable Television Consumer)
Protection and Competition Act)
of 1992)

MM Docket 93-215

and)

Adoption of a Uniform Accounting)
System for Provision of)
Regulated Cable Service)

CS Docket 94-28 ✓

COMMENTS OF BELL ATLANTIC¹

In the short time since the Commission issued the Further Notice in this proceeding,² there have been continued signs that the convergence between the cable and telephone industries is accelerating. To an ever increasing degree, these previously separate industries are competing directly with one another to provide the same services using the same technologies. Under these circumstances, it is critical that the Commission adopt rules that will promote investment and innovation by both cable and telephone companies, without

¹ The Bell Atlantic telephone companies are Bell Atlantic - Delaware, Inc., Bell Atlantic - District of Columbia, Inc., Bell Atlantic - Maryland, Inc., Bell Atlantic - New Jersey, Inc., Bell Atlantic - Pennsylvania, Inc., Bell Atlantic-Virginia, Inc., and Bell Atlantic - West Virginia, Inc.

² Implementation of the Cable Act of 1992: Rate Regulation and Adoption of a Uniform Accounting System, Report and Order and FNPRM, MM Dkt 93-215 & CS Dkt 94-28 (rel. March 30, 1994) ("Order" or "Further Notice").

artificially favoring or handicapping one over the other in the marketplace. While we have urged removal of unnecessary and burdensome regulation of telephone companies in other contexts, so long as the Commission pervasively regulates telephone companies it must impose equivalent requirements on cable to avoid skewing competitive results to the ultimate detriment of consumers.

1. The convergence of cable and telephone companies is accelerating.

Through their ownership of competitive access providers ("CAPs"), cable companies already are a major competitor for telephone services.³ More recently, cable companies have been entering into direct competition for local exchange service. For example, Southwestern Bell plans to provide ubiquitous local exchange service in competition with Bell Atlantic in Montgomery County, Maryland.⁴ Cable companies also have made numerous other forays into traditional telephone services.⁵

³ In Bell Atlantic's region alone, Eastern TeleLogic, Teleport, Cox Fibernet, AlterNet, Penn Access and M. H. Lightnet are all CAPs owned in whole or in part by cable companies. Affidavit of Richard E. Beville in Support of Comments of Bell Atlantic, Price Cap Review for Local Exchange Companies, CC Dkt 94-1, at ¶¶ 7 c, 13 & 14 (filed May 9, 1994).

⁴ Application of SBC Media Ventures, Inc. for Authority to Provide Local Exchange Telecommunications Service, Before the Public Service Commission of Maryland (filed May 20, 1994).

⁵ See Affidavit of Robert G. Harris, at ¶¶ 16-18 (June 29, 1994) ("Harris Aff.") (attached hereto).

The natural policy outgrowth of this convergence is an equally accelerating move toward regulatory parity. The Commission itself has recognized "the merits of moving toward regulatory parity for cable and telephone regulation,"⁶ and recently held that "as the cable and telephone industries converge, it is important to treat them with as much regulatory parity as possible."⁷ While it is true that any legitimate differences between the industries should be taken into account,⁸ there are no differences which could justify giving preferential treatment to cable on the issues raised in the Further Notice.

2. The Commission Should Adopt Equivalent Productivity Offsets for Cable and Telephone Companies

Bell Atlantic has shown in the ongoing review of the price rules for local telephone companies that a properly

⁶ Further Notice at ¶ 319.

⁷ Implementation of Sections of the 1992 Cable Act - Rate Regulation, MM Dkt 92-266, 2d Order on Recon., 4th Report and Order, and 5th NPRM at ¶ 24 (rel. Mar. 30, 1994). The administration strongly agrees. See Testimony of Larry Irving, Asst. Commerce Secretary, Before the House Subcommittee on Economic and Commercial Law at 7 (Jan. 26, 1994) ("As Vice President Gore emphasized on January 11, we are moving away from a world where technologically valid regulatory distinctions may be made among local telephone, long distance telephone, cable, and other purveyors of information transmission.... Regulatory policies predicated on the old boundaries can harm consumers by impeding competition and discouraging private investment in networks and services.").

⁸ See Harris Affidavit at ¶ 9, n.1.

structured price cap plan will strongly promote infrastructure development along with economic efficiency and growth.⁹ This is equally true in the case of the cable industry.

The Commission correctly recognizes, however, that an important component of such a price cap plan for cable is a productivity offset akin to that for local telephone companies.¹⁰ As in the case of telephone companies, applying this price cap structure to cable will encourage improvements in productivity and efficiency, and promote deployment of advanced new technologies.¹¹ In fact, this is doubly true in the case of cable companies, which have operated historically as unregulated monopolists with neither regulatory constraints on their prices nor competitive prods to improve efficiency and productivity.

Moreover, the Commission also is correct that cable's productivity growth will be equivalent to that of other communications firms.¹² As the Commission itself

⁹ Comments of Bell Atlantic, filed in Price Cap Performance Review for Local Exchange Carriers, CC Dkt 94-1 (filed May 9, 1994) ("Bell Atlantic Price Cap Comments").

¹⁰ Further Notice at ¶ 319.

¹¹ Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd 6786, 6789-91, and Erratum, 5 FCC Rcd 7664 (1990) ("LEC Price Cap Order"), mod'd on recon., 6 FCC Rcd 2637 (1991).

¹² See Further Notice at ¶ 319 ("We also tentatively conclude that cable operators should reasonably be expected to achieve productivity gains in the future analogous to those historically realized by other communications firms.").

recognizes,¹³ and as Dr. Robert Harris confirms in the accompanying affidavit,¹⁴ the similarity between the technology used by the cable and telephone industries as well as the accelerating convergence of the two both point towards analogous productivity growth.¹⁵ Consequently, the Commission should adopt a productivity offset for cable that is at least equivalent to the offset that is ultimately adopted for local telephone companies in the ongoing price cap review proceedings.¹⁶

In fact, if the Commission were to distinguish between cable and telephone companies in terms of the productivity offsets it adopts, the offset for telephone

¹³ Further Notice at ¶ 319; see also Implementation of the Cable Act of 1992 - Rate Regulation, MM Dkt 93-215, NPRM, at ¶ n.16 (rel. July 16, 1994) (recognizing that an equivalent offset is necessary to "harmonize incentives for converging technologies").

¹⁴ Harris Aff. at ¶¶ 10-13.

¹⁵ See also Affidavit of Robert L. Townsend, MM Dkt 93-215, at ¶¶ 3-16, attached to the Joint Comments of Bell Atlantic, et al., MM Dkt 93-215 (filed Aug. 25, 1994).

¹⁶ Harris Aff. at ¶¶ 9-13. As Bell Atlantic has shown in those proceedings, a reasonable productivity offset for local telephone companies should be no higher than the 1.7 percent long term total factor productivity growth historically experienced by the industry. See Bell Atlantic Price Cap Comments at 13-17; Lauritis R. Christensen, et al., Productivity of the Local Telephone Operating Companies (May 3, 1994), attached to Comments of USTA, Price Cap Performance Review for Local Exchange Carriers, CC Dkt 94-1 (filed May 9, 1994). But even if the Commission were to incorrectly adopt a higher offset for local telephone companies, in no event could it adopt a lower offset for cable.

companies would have to be lower. As explained by Dr. Harris, this is true because telephone companies have already deployed more productivity enhancing technologies, such as fiber optics and digital switching, than has cable.¹⁷ As a result, telephone companies have already experienced the productivity gains that result. In contrast, cable companies have begun aggressively deploying the same technologies and will experience greater productivity growth in coming years as they add such technology to their systems.¹⁸ Because cable operators will reap the greater productivity growth in the future, cable should have the higher offset.

Finally, neither industry should be saddled by having an arbitrary "stretch factor" or "consumer productivity dividend" tacked onto their expected rate of future productivity growth.¹⁹ But in no event could imposing such an add-on be justified for local telephone companies but not their cable competitors.

¹⁷ Harris Affidavit at ¶ 13.

¹⁸ Further Notice at ¶ 319.

¹⁹ See Further Notice at ¶ 316.

3. The Commission Should Set Cable's Rate of Return According to the Same Principles That Apply to Telephone Companies

As Dr. James H. Vander Weide explained in an earlier round of this proceeding,²⁰ the overall return that cable companies are allowed to earn when they elect to go through a cost of service proceeding should be computed using the same principles that historically were applied to telephone companies. Specifically, cable's overall return should be computed using its cost of equity, and its actual cost of debt and actual capital structure.

Nonetheless, the cable commenters will no doubt renew their usual argument that they should automatically be given a higher return than telephone companies would be permitted in such circumstances. This argument, however, is based on the erroneous claim that cable companies face greater business risk than telephone companies.

As explained by Dr. Vander Weide, telephone companies face significantly greater competitive pressure than cable operators and a correspondingly greater business risk.²¹ This differential continues to grow, as competition for

²⁰ See Affidavit of James H. Vander Weide, MM Dkt 93-215, at ¶¶ 5-11, attached to Joint Comments of Bell Atlantic, et al., MM Dkt 93-215 (filed Aug. 25, 1994) ("Vander Weide Aff.").

²¹ See Vander Weide Aff.

interstate telephone services increases rapidly. Cable operators, competitive access providers, interexchange carriers, utility companies, and wireless providers have all moved aggressively to compete for these services -- both alone and in combination.²²

In contrast, cable operators still face virtually no multichannel competition. The long heralded arrival of DBS has not yet materialized.²³ But even if it does, DBS does not provide a complete competitive alternative to cable since it does not provide local programming. Meanwhile, attempts to overbuild cable incumbents have stalled or failed.²⁴ And competition from telephone companies is stalled due to delays

²² See id. at 12. The rapid increase in competition is occurring nationwide, see Peter Huber, The Enduring Myth of the Local Bottleneck (Mar. 14, 1994); Robert G. Harris, Economic Benefits of LEC Price Cap Reforms, at 8-11 & App. B, attached to Comments of USTA, Price Cap Performance Review for Local Exchange Carriers, CC Dkt 94-1 (filed May 9, 1994), and in Bell Atlantic's telephone service areas as well, see Affidavit of Richard E. Beville, Price Cap Performance Review for Local Exchange Carriers, CC Dkt 94-1 (filed May 9, 1994).

²³ In fact, the only DBS operation currently offering service nationwide (Primestar) is owned by a consortium of cable companies and 95 percent of its customers are in homes not passed by cable. See Bulletin: Yankeevision - Consumer Communication, The Yankee Group, 11:4 at 1-3 (Mar. 1994).

²⁴ See, e.g., "Florida Municipal Overbuilders in Wait Mode," Multichannel News, at 37 (Oct. 18, 1993) (describing a Florida city's 7 year legal battle with the cable incumbent).

in necessary regulatory approvals to deploy competing video dialtone systems.²⁵

It is true that cable is more highly debt leveraged than telephone companies, but this does not offset the greater business and regulatory risk faced by telephone companies. In any event, this was taken into account by Dr. Vander Weide²⁶ and the Commission²⁷ in determining cable's cost of equity. Moreover, the net effect of cable's heavy reliance on debt is to lower cable's required return overall because of the lower cost of debt.

4. The Commission Should Adopt Affiliate Transaction, Uniform Accounting and Cost Allocation Rules For All Cable Operators Equivalent to Those for Telephone Companies

Although the Commission has adopted or proposed affiliate transaction, uniform accounting, and cost allocation rules for cable that are similar in some respects to the rules for telephone companies,²⁸ it now proposes to eliminate whatever measure of equity it has created.²⁹ It would do so

²⁵ At present, there are a total of 24 different video dialtone applications or amendments awaiting Commission action, representing a total of over \$3.3 billion of proposed infrastructure investment.

²⁶ Vander Weide Aff. at ¶¶ 19-20.

²⁷ See Order at ¶ 177.

²⁸ See generally Order at ¶¶ 217-21, 237-40, 261-71, and Further Notice at ¶¶ 309-331.

²⁹ Further Notice at ¶¶ 306-313.

by exempting cable companies from these rules except in two narrow circumstances -- where cable companies elect to initiate a cost of service proceeding, or to pass through external costs in rates.³⁰

The result of this proposal would be to free cable companies from any of these rules whenever they operate under price caps. While there is undoubtedly merit to this proposal if applied to both industries, telephone companies remain subject to a full range of affiliate transaction, accounting and cost allocation rules even under price caps. Until telephone companies are freed of these rules, cable companies should be subject to them as well.

In fact, the cable industry claims that telephone companies should be subject to even further rules as they begin to move into the video marketplace.³¹ But again, whatever rules apply to telephone companies as they move into video should apply equally to cable companies as they move into telephony.

Affiliate Transaction Rules. The Commission also proposes here to impose the same affiliate transaction rules

³⁰ Id.

³¹ See Petition for Rulemaking of NCTA, et al., Amendment of the Commission's Rules to Establish and Implement Regulatory Procedures For Video Dialtone Service, RM 8221 (filed Apr. 8, 1993).

on cable that it has proposed for telephone companies.³² While there are strong arguments for less restrictive requirements,³³ the Commission correctly recognizes that whatever rules are ultimately adopted for telephone companies should apply equally to cable as well.³⁴

Uniform Accounting Rules. While the Commission's proposed uniform system of accounts for cable is adapted from its rules for telephone companies, it bases the rules for all cable companies on the rules for class B carriers.³⁵ In contrast, telephone companies with revenues over \$100 million are required to conform to the Class A system of accounts,³⁶ which the Commission acknowledges are far more

³² Further Notice at ¶ 309.

³³ See Comments of Bell Atlantic, Amendment of Parts 32 and 64 of the Commission's Rules, etc., CC Dkt 93-251 (filed Dec. 10, 1993).

³⁴ Indeed, there is no reasonable basis for a distinction, and differences in requirements would impose additional costs and unfair handicaps on one industry compared to the other. See Harris Affidavit at ¶ 8.

³⁵ Further Notice at ¶ 307.

³⁶ A number of cable operators have revenues far in excess of the Commission threshold. See Paul Kagan & Associates, Cable Financial Databook, at 62 (June 1993).

burdensome.³⁷ There is no basis for drawing such a distinction. While a far better course would be to allow all cable and telephone companies to use the less burdensome Class B system, so long as the Commission keeps a size dichotomy for telephone companies, it should do the same for cable.

5. The Commission Should Adopt Rules For New Services Provided By Cable and Telephone Companies Alike That Will Promote Investment and Innovation

As part of its upgrade incentive plan, the Commission proposes to grant cable operators pricing flexibility for new services in exchange for keeping the price of existing services at or below the level permitted by the price cap formula.³⁸ The Commission is correct that such a plan not only will spur innovation by creating an incentive to develop and introduce new services, but will also promote infrastructure investment.³⁹ In fact, these are the very

³⁷ Id. at ¶ 307. Presumably the class A rules were imposed on the theory that more detail was needed for larger and more varied businesses. But if this is true for telephone companies, it is at least equally true for large cable companies with their more varied business interests ranging from cable systems, to programming, to telephony.

³⁸ Further Notice at ¶ 324.

³⁹ Id.

reasons that Bell Atlantic proposed to remove new services from price caps in its own price cap proceeding.⁴⁰

Nonetheless, it would be unreasonable to give cable companies the benefit of an incentive upgrade plan without extending similar relief to telephone companies. To do so would give cable an enormous competitive advantage by leaving telephone companies handicapped in the race to deliver innovative new products to market. As a result, the Commission should give both industries greater flexibility for new services and allow the marketplace to judge the best products.⁴¹ Ultimately, it is consumers of these services that will be the winners in such a race.

⁴⁰ Bell Atlantic Price Cap Comments at 23-26. For the same reasons, Bell Atlantic proposed removing discretionary services from price cap regulation, *id.*, just as discretionary cable services such as premium channels and pay-per-view are exempt from regulation today.

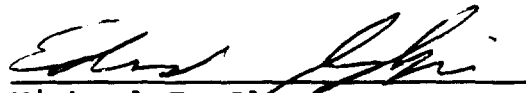
⁴¹ Moreover, new services are by definition also discretionary, and there is no reason to impose regulatory restrictions on either industry.

Conclusion

By regulating cable and telephone companies on the same basis, the Commission will encourage further competition between the two, and ultimately ensure that success or failure in either industry is a result of market forces and not artificial regulatory restraints. Accordingly, the Commission should adopt rules here that are equivalent to those for telephone companies.

Respectfully submitted,

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July 1, 1994

ATTACHMENT

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington D.C.**

In the matter of)	
)	
Implementation of Sections of the Cable)	MM Docket No. 93-215
Television Consumer Protection and)	
Competition Act of 1992: Rate Regulation)	
)	
and)	
)	
Adoption of a Uniform Accounting System)	CS Docket No. 94-28
for Provision of Regulated Cable Service)	

DECLARATION OF ROBERT G. HARRIS

A. Qualifications

1. My name is Robert G. Harris. I am an Associate Professor in the Walter A. Haas School of Business, University of California, Berkeley. I earned Bachelor of Arts and Master of Arts degrees in Social Science from Michigan State University and Master of Arts and Doctor of Philosophy degrees in Economics from the University of California, Berkeley. At Berkeley, I teach undergraduate, MBA and PhD courses, including Business & Public Policy; Economics for Managerial Decisions; Antitrust and Economic Regulation; and Competitive Strategies and Public Policies in Telecommunications Industries. My academic research has analyzed the effects of economic regulation and antitrust policy on economic performance, and the implications of changing technologies and economics for public policies, especially in telecommunications and transportation. My curriculum vitae is Appendix 1 to this testimony.

2. While on leave from the University in 1980-81, I served as a Deputy Director for Cost, Economic and Financial Analysis of the Bureau of Accounts at the Interstate Commerce Commission. In that capacity, I supervised the work of approximately 90 staff accountants and analysts in rate and complaint case proceedings; was centrally involved in several major rule makings implementing the motor carrier and railroad regulatory reform acts of 1980, including the adoption of incremental and stand-alone costs for ratemaking; and directed the implementation of the revised Uniform System of Accounts and the development of the Uniform Rail Costing System. Since 1981, I have served as a consultant to the United States Department of Transportation, the United States General Accounting Office, the United States Office of Technology Assessment, the United States Department of Justice, the California Attorney General and the California Department of Consumer Affairs. I have also been a consultant to telecommunications and transportation companies regarding product pricing, new product development, regulatory policy and competitive strategy.

B. Purpose of Declaration

3. This declaration will respond to the Commission's invitation to comment on its proposed 2% productivity offset in the cable price cap formula. In addition to providing an economic analysis of the productivity offset factor, I will explain why, in this proceeding and in the review of local exchange carrier (LEC) price caps, it is crucially important that the Commission consider the implications of its regulation of one industry for the other. Section C addresses the need for comparable price cap rules and the implications of symmetrical treatment for setting the productivity offset factor for cable. It is critical that the offset be set on the same conceptual basis in both industries. Though these specific decisions will be made in separate proceedings, the Commission should ensure that its rules do not bias or distort the competitive balance between cable and LECs. By adopting

comparable regulations, it will contribute to healthy competition for investment capital, for innovation and new services, and for customers.

4. Section D will provide further evidence of existing competition between cable companies and LECs across an array of telecommunications services. It will also explain how, within the next few years, the degree of competition between LECs and cable will grow to major proportions as further "cross-entry" occurs: cable operators enter local exchange telephone services and LECs enter video program delivery through video dialtone. Growing competition between two industries, whether railroads and motor carriers or cable operators and LECs, increases the need for comparable regulation, because it increases the distortions and disincentives caused by regulatory differences or asymmetries.

5. The historic lesson from surface freight transportation is clear: as explained in Section E, the failure of the ICC to follow this principle caused enormous inefficiencies, competitive imbalances and economic dislocations. Customer choices between rail and motor carriage were driven not by the respective economics of the two modes of transportation, but by regulatory asymmetries that handicapped rail carriers from competing effectively with growing truck competition. Today, after fourteen years of reforms that both reduced regulation and restored balance, there is healthy competition -- and cooperation in intermodal services -- between the two industries. It is vital to the realization of the National Information Infrastructure that the Commission draws on the experience of the Interstate Commerce Commission by explicitly recognizing the need for comparable or corresponding regulatory treatment of cable and LECs.

C. The Need for Comparable Price Cap Regulation of LECs and Cable

6. The U.S. has a long history of regulating four major sectors of the economy: financial services, energy, transportation and telecommunications. Within each of these sectors, there are -- or were, due to regulatory distinctions -- several individual industries. In the financial sector, for example, we had separate and different regulatory policies for commercial banks, savings and loans, mutual banks and credit unions. Over time, the "industries" in each of these sectors became increasingly competitive, as banks competed with S&Ls, railroads with trucks, and electricity with natural gas. As "intermodal" competition increased, it became evident by the 1970's that separate and different regulations were causing economic distortions, dislocations and inefficiencies. In response -- delayed reaction would be a more accurate term -- legislators and regulators acted to remove obstacles to intermodal competition within these sectors and substantially reformed regulations toward each of the respective industries to promote balanced competition and create level playing fields. Unfortunately, by then, substantial economic harm had been caused by the failure to modify regulations in recognition of the growing competition among these industries.

7. One would hope we have learned an important lesson from those historical experiences: that the more directly two industries compete, the more important it is that regulations toward the two industries are comparable, corresponding or symmetrical. Companies in the two industries are, after all, competing in capital markets. Because investors are forward-looking and recognize the impact of regulations upon opportunities for growth and profitability, they specifically consider the respective regulations toward the two industries. What may seem to be small differences in regulatory treatment may substantially impact investors' valuations of the companies' prospects, and hence, their share prices, cost of capital and ability to attract investment. Regulations that limit new service offerings in one industry, while openly encouraging new services by the other, will

bias investors toward the latter. Regulations that limit the profits of one industry while allowing firms in the other industry to earn what they can based only on market performance will bias capital markets toward the latter.

8. Similarly, competition in outputs markets raises the costs of asymmetrical regulatory treatment. In the days when one industry has a monopoly over a given category of service, the price set by regulators may have caused customers to buy somewhat more or somewhat less, depending on the elasticity of demand. Now, though, when there is another provider of an equivalent or similar service, customers will readily switch from one supplier to another, based on the best combination of price and quality of service. If regulators set prices -- or establish price regulation regimes -- that cause price distortions in one industry relative to the other industry, they are biasing customers' choices, creating a competitive advantage for one industry and "handicapping" the other industry. Economic regulation is not a recreational sport: handicapping may be a good method of promoting competition in golf or bowling. In regulation, handicapping is a very bad idea, because it prevents investors and customers from making unbiased choices among competitive alternatives.

9. Both in terms of technology and in terms of services offered, the telephone and cable industries are rapidly converging. Though some differences may remain,¹ the industries are already competing in some markets and will soon be competing across the full range of telecommunications services. Because these industries are becoming head-to-head competitors, it is critically important to the performance of both industries that the

¹ One difference in regulatory treatment of LECs and cable operators is that, under the Commission's regulations, it is intended that rates for basic cable service be fully compensatory -- including a fair profit -- to the cable operator. In many states, by contrast, rates for basic telephone service do not recover economic costs, much less enable the LECs to earn a fair profit. Instead, regulated rate structures often impose higher prices on some LEC customers to subsidize the LECs' universal service obligation. By raising prices on those services, these subsidies are a major source of competitive disadvantage for LECs.

regulation of the cable and LECs be comparable or corresponding in certain fundamental respects. There are a number of areas in which the industries should be accorded comparable or corresponding treatment.

10. In determining the productivity offset factors for cable and LECs, the Commission should take a logically consistent approach toward both industries. It is especially important that the Commission not distort the price cap mechanisms by including an offset for LECs but excluding an offset from the cable price caps. There is no basis for such a distinction. Indeed, there are reasons why the Commission should adopt comparable productivity offsets for cable and LECs, one related to equity, the other based on economic efficiency. As to equity, it should be noted that the price cap regulation of cable rates relates to basic cable service, whereas LEC price caps limit access rates, which are reflected in long distance prices. Although cable service may not be a "utility" service in the classical sense, there is no basis for believing that basic cable service is any less essential to American consumers than long distance telephone service. Although just 60% of US households subscribe to cable service, that may reflect its high price, rather than households not wanting to subscribe. Indeed, that is the central rationale of the Cable Act and the Commission's regulation of basic cable service rates.² As to efficiency, both the cable and LEC price caps should reward efficiency-seeking behavior to the same degree: those firms that can exceed the historic industry norms should earn higher profits, while those who cannot, will not.

² "The average monthly cable rate has increased almost 3 times as much as the Consumer Price Index since rate deregulation." See Section 2(a)(1), Cable Television Consumer Protection and Competition Act of 1992, Pub. L. 102 - 385, 106 Stat. 1480 (1992). "Without the pressure of another multichannel video programming distributor, a cable system faces no local competition. The result is undue market power for the cable operator as compared to that of consumers and video programmers." *Id.*, Section 2(a)(2).

11. In both industries, the economically correct productivity offset in a price cap model is the expected rate of productivity gains in the future. The best indicator of future productivity gains is historical experience, over a sufficiently long period to reduce anomalous yearly fluctuations. This is the basis of the recommendation by the New Jersey Board of Regulatory Commissioners that the Commission adopt a 2% productivity offset for cable.³ The Board noted that it "has recently adopted such an approach in the context of an economic regulation for a local exchange carrier." But in making its recommendation, the New Jersey Board also recognizes -- as should this Commission -- the need for comparable regulatory treatment of cable and LECs.

12. The New Jersey recommendation also makes economic sense because, given the growing convergence of both the technology and services offered between cable and LECs, one would expect the two industries to have similar rates of productivity growth. A recent review of productivity studies by NERA found that "the long-run productivity differential between the U.S. telephone industry and U.S. private business averages about 2 percent per year."⁴ A recent empirical study of productivity by Christensen Associates found that "the TFP [Total Factor Productivity] growth differential between the LECs and the private business sector since divestiture has been 1.7 percent."⁵

³ Staff Comments, New Jersey Board of Regulatory Commissioners, submitted in FCC MM Docket No. 92-266, January 26, 1993, p. 16.

⁴ Economic Performance of the LEC Price Cap Plan, National Economic Research Associates, Inc. Attachment 5 to Comments of the United States Telephone Association to the Federal Communications Commission, In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, p. 23.

⁵ Productivity of the Local Operating Telephone Companies Subject to Price Cap Regulation, Christensen Associates. Attachment 6 to Comments of the United States Telephone Association to the Federal Communications Commission, In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, p. 12.

13. In its Notice of Proposed Rulemaking, the Commission suggested that expected productivity gains in the cable industry might be lower than those achieved historically:

"In the near term, however, the productivity that cable operators may reasonably be expected to achieve may differ from that of telephone companies, because of current differences in their networks, operations, services and histories. For example, local telephone companies have benefited from advances in computerized local switches, which are not in general use by cable systems."⁶

While factually correct, the inference drawn from the facts is incorrect. Because LECs have already installed digital switching and transmission, they have already realized the productivity benefits from adoption of digital technology. Because cable operators are just now deploying digital switching and transmission capabilities, they will be realizing the benefits during the price cap plan. Hence, as cable operators install optical fiber in trunks and digital switches, they should experience substantial gains in productivity over historic rates. In contrast, LECs have already largely deployed digital switches and optical fiber trunks, so there are fewer further productivity gains to be realized from these technologies by LECs. Second, whereas most expected cost increases are covered by the LEC price cap, a major category of costs is treated as exogenous for cable, namely the costs of program acquisition. Given these asymmetries, it is all the more important that the productivity offset be comparable for the two industries.

14. Just as the Commission is not contemplating a "stretch factor" or "consumer dividend" for cable rates, it should not incorporate these additives in its LEC offset factor. Moreover, LEC customers also continue to receive a "dividend" from the uneconomic depreciation rates of LECs, which lowered the initial access rates under the current price cap regime. As the "base rates" to which price cap changes will apply, consumers receive

⁶ Report and Order and Further Notice of Proposed Rulemaking, MM Docket No. 93-215 and CS Docket No. 94-28, March 30, 1994, par. 319, p. 162.

this dividend into the indefinite future. In the cable price cap plan, in contrast, the initial rates reflect fully economic (i.e., higher) depreciation rates, whether implicit in the competitive benchmark rates, or explicit in the cost of service determination of initial rates. The inclusion of an additional consumer dividend in the price cap formula for LECs when none is included for cable would create a regulatory bias between the two industries.

15. The comparability of incentives is crucial to building the National Information Infrastructure. To ensure competition in the provisioning of interactive, broadband and other advanced telecommunications services, there should be at least "two wires to the home." LECs and cable operators are in a competitive race to upgrade their networks; both should be actively encouraged. The barriers to competition within and between the two modes should be eliminated, so long as that is done symmetrically and synchronously. The Commission could greatly bias the race, and severely distort the results, by lowering the barriers in one direction but not the other. Similarly, the rewards of winning the race should be comparable: by providing comparable economic incentives, both cable and LECs can be "medal winners," whether gold, silver or bronze. The two-wire strategy simply will not work otherwise.

D. Competition between Cable Companies and LECs

16. There is growing competition between cable operators and local exchange carriers. Cable operators are major players in the provision of competitive access services to end-users, interexchange carriers and wireless carriers. They are using their networks to provide backhaul of voice and data transmissions to cellular providers and competitive access providers (CAPs) are forming alliances to build and interconnect CAPs and cable networks. While more exhaustive descriptions are available elsewhere, a few examples of the various types of arrangements serve to make the point:

- Cox and TCI acquired Teleport Communications Group (TCG), the largest CAP, and sold minority stakes to the two other MSOs in 1993. The acquisition was completed with the intent of setting up ventures with local cable systems, which would hold stakes representative of their share of the market, leaving some portion of the business to the national Teleport venture.⁷ Cox owns a 25.05% stake, followed by TCI with 24.95%, and Time Warner, Comcast, and Continental with 16.67% each.
- TCI, American Television and Communications (ATC) & TeleCable have participated in a joint venture known as FiberNet, since 1989 in and around Kansas City, Mo. The all-fiber network, covering close to 200 route miles on both sides of the Missouri River, now serves upwards of eight interexchange carriers, several airline reservation subsidiaries, financial brokerage houses and other large firms requiring diverse paths to carry their traffic.⁸
- PacTel Cellular Detroit has replaced some LEC-provided local loop circuits with leased cable TV fiber to connect to IXCs' facilities and uses fiber in combination with microwave for its network.⁹
- Continental Cable and Hyperion, a subsidiary of Adelphia, have set up a metropolitan area network through a joint venture in Jacksonville, Fla. The network utilizes Continental's existing fiber backbone and a series of fiber rings and fiber

⁷ "Cable as the Alternative," *Cablevision*, March 22, 1993.

⁸ "In Teleport's Shadow," *Cablevision*, September 21, 1992.

⁹ Peter Huber, "The Enduring Myth of the Local Bottleneck," 1994, p. 39.